

State Board of Land Commissioners  
Regular Agenda  
December 11, 2001

Subject

Revised "Variable Spending Policy" and Fiscal Year 2003 Distribution to Beneficiaries

Background

At their September 11, 2001 regular meeting, the State Board of Land Commissioners deferred a decision on the Endowment Fund Investment Board's recommendation to lower the current distribution to beneficiaries from 8.5% to 7.5%. Please refer to the attachment for the information as presented at the September 11, 2001 meeting. This action was recommended due to the recent equity market drop, coupled with timber revenues that are lower than used in the original Variable Spending Policy.

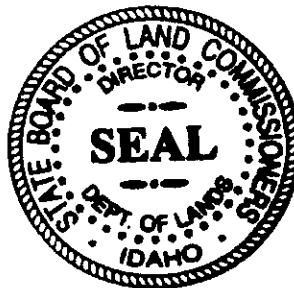
In order to establish Fiscal Year 2003 budgets, a Land Board decision concerning the distribution to the beneficiaries from the endowment funds is necessary.

Recommendation

That the State Board of Land Commissioners approve the revised "Variable Spending Policy" and lower the distribution percentage from 8.5% to 7.5% beginning in fiscal year 2003.

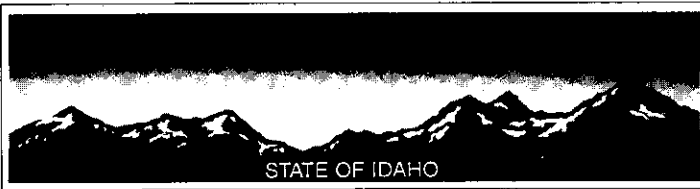
Board Action

**December 11, 2001.** A motion was made by Attorney General Lance to modify the department's recommendation to reflect the phase-in as recommended in the Endowment Fund Investment Board's letter of December 5, 2001, which reads: "After reexamining the fund balances and considering the impact upon the earnings reserve fund and upon the beneficiaries, the Endowment Fund Investment Board reaffirmed its goal to move to a 7.5% distribution to beneficiaries in order to achieve its earnings reserve goals. However, if the Board of Land Commissioners desires, this goal could be attained through a two-step process: 8% the first year (fiscal year 2003) and 7.5% for succeeding years. The result of this phase-in approach will not significantly affect the time needed to reach the goal of a 50% fund reserve." Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 5-0.



Attachment

1. Copy of Approved Land Board Memo September 11, 2001
2. Copy of the Revised "Variable Spending Policy" and Five Year Distribution to Beneficiaries [as presented to the board at the September 11, 2001 meeting]



DIRK KEMPTHORNE, GOVERNOR

**CHARLES G. SAUMS**  
MANAGER OF INVESTMENTS

MEMBERS  
NORMAN N. (NICK) HALLETT, CHAIRMAN

M. DEAN BUFFINGTON  
DEAN L. CAMERON  
WILLIAM W. DEAL  
GAVIN M. GEE

WILLIAM D. MITCHELL  
R. JOHN TAYLOR  
BARBARA L. WILSON  
PARKER G. WOODALL

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## ENDOWMENT FUND INVESTMENT BOARD

Telephone (208) 334-3311

350 North Ninth Street, Suite M-100

Boise, Idaho 83702-5459

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December 5, 2001

Winston A. Wiggins, Secretary  
Board of Land Commissioners  
State of Idaho  
P.O. Box 83720  
Boise, Idaho 83720-0050

Dear Secretary Wiggins:

On December 5, 2001, the Endowment Fund Investment Board called a special meeting to discuss the income distribution to the beneficiaries of the endowment funds. The board expressed recognition that the change to a rate of 7.5% as the Variable Spending Policy recommends would have a major impact on the public school funds in fiscal year 2003, given the poor economic conditions and the cash-flow problems the State of Idaho is currently experiencing.

After reexamining the fund balances and considering the impact upon the earnings reserve fund and upon the beneficiaries, the Endowment Fund Investment Board reaffirmed its goal to move to a 7.5% distribution to beneficiaries in order to achieve its earnings reserve goals. However, if the Board of Land Commissioners desires, this goal could be attained through a two-step process: 8% the first year (fiscal year 2003) and 7.5% for succeeding years. The result of this phase-in approach will not significantly affect the time needed to reach the goal of a 50% fund reserve.

Please note the enclosures for data pertaining to this recommendation.

Sincerely,

Norman N. (Nick) Hallett  
Chairman of the Endowment Fund Investment Board

NNH:ml

Enclosures

## 7.50% SPENDING POLICY

### FUND BALANCE PROJECTIONS FISCAL YEAR 2002

	PUBLIC SCHOOL	POOLED	TOTAL
PERMANENT FUND CORPUS 6/30/01	515,590,463	236,818,142	752,408,605
MINERALS AND LAND SALES	2,046,600	228,000	2,274,000
PERMANENT FUND CORPUS 6/30/02	517,637,063	237,046,142	754,682,605
EARNINGS RESERVE 6/30/01	29,554,264	19,934,687	49,488,951
LAND DEPT RECEIPTS	37,260,000	24,840,000	62,100,000
INVESTMENT INCOME	11,700,000	5,275,000	16,975,000
DISTRIBUTION—BENEFICIARIES	(47,675,000)	(21,965,000)	(69,640,000)
DISTRIBUTION—EXPENSES			
DEPT OF LANDS	(9,239,978)	(4,352,022)	(13,592,000)
ENDOWMENT	(2,214,156)	(1,042,866)	(3,257,022)
EARNINGS RESERVE 6/30/02	19,385,130	22,689,799	42,074,929

### FUND BALANCE PROJECTIONS FISCAL YEAR 2003

	PUBLIC SCHOOL	POOLED	TOTAL
PERMANENT CORPUS 6/30/02	517,637,063	237,046,142	754,683,605
MINERALS AND LAND SALES	2,263,500	251,500	2,515,000
PERMANENT CORPUS 6/30/03	519,900,563	237,297,642	757,198,605
EARNINGS RESERVE 6/30/02	19,385,130	22,689,799	42,074,929
LAND DEPT RECEIPTS	36,180,000	24,120,000	60,300,000
INVESTMENT INCOME	10,800,000	5,050,000	15,850,000
DISTRIBUTION—BENEFICIARIES	(40,605,000)	(18,680,000)	(59,285,000)
DISTRIBUTION—EXPENSES			
DEPT OF LANDS	(10,061,188)	(4,738,812)	(14,800,000)
ENDOWMENT	(2,328,349)	(1,096,651)	(3,425,000)
EARNINGS RESERVE 6/30/03	13,370,593	27,344,336	40,714,929

**PROJECTIONS FOR FY 2002 AND FY 2003 ARE MADE WITH THE FOLLOWING ASSUMPTIONS:**

- 1) THE EQUITY MARKET IS STABLE AT CURRENT LEVELS.
- 2) LAND DEPT RECEIPTS ARE RECEIVED EQUALLY THROUGHOUT THE YEAR.
- 3) EXPENSES ARE ACTUAL APPROPRIATED FOR FY 2002 AND HAVE SLIGHT INCREASES FOR FY 2003
- 4) DISTRIBUTIONS TO BENEFICIARIES ARE AS APPROPRIATED FOR FY 2002 AND HAVE BEEN REDUCED FOR FY 2003 TO A 7.50% SPENDING POLICY.
- 5) INTEREST INCOME WILL BE HIGHER THAN PROJECTIONS. SHORT TERM INCOME AND DIVIDENDS FROM EQUITIES ARE INCLUDED ON THE CONSERVATIVE SIDE.
- 6) LAND DEPT RECEIPTS PROJECTIONS ARE SPREAD—PUBLIC SCHOOL 60% POOLED 40%.
- 7) DISTRIBUTION FOR FY 2003 HAS BEEN UPDATED AS OF SEPTEMBER 2001. EVERYTHING ELSE REMAINS AS IN ORIGINAL PROJECTIONS.

## 8% PHASE-IN SPENDING POLICY

### FUND BALANCE PROJECTIONS FISCAL YEAR 2002

	PUBLIC SCHOOL	POOLED	TOTAL
PERMANENT FUND CORPUS 6/30/01	515,590,463	236,818,142	752,408,605
MINERALS AND LAND SALES	2,046,600	228,000	2,274,000
PERMANENT FUND CORPUS 6/30/02	517,637,063	237,046,142	754,682,605
EARNINGS RESERVE 6/30/01	29,554,264	19,934,687	49,488,951
LAND DEPT RECEIPTS	37,260,000	24,840,000	62,100,000
INVESTMENT INCOME	11,700,000	5,275,000	16,975,000
DISTRIBUTION--BENEFICIARIES	(47,675,000)	(21,965,000)	(69,640,000)
DISTRIBUTION--EXPENSES			
DEPT OF LANDS	(9,239,978)	(4,352,022)	(13,592,000)
ENDOWMENT	(2,214,156)	(1,042,866)	(3,257,022)
EARNINGS RESERVE 6/30/02	19,385,130	22,689,799	42,074,929

### FUND BALANCE PROJECTIONS FISCAL YEAR 2003

	PUBLIC SCHOOL	POOLED	TOTAL
PERMANENT CORPUS 6/30/02	517,637,063	237,046,142	754,683,605
MINERALS AND LAND SALES	2,263,500	251,500	2,515,000
PERMANENT CORPUS 6/30/03	519,900,563	237,297,642	757,198,605
EARNINGS RESERVE 6/30/02	19,385,130	22,689,799	42,074,929
LAND DEPT RECEIPTS	36,180,000	24,120,000	60,300,000
INVESTMENT INCOME	10,800,000	5,050,000	15,850,000
DISTRIBUTION--BENEFICIARIES	(43,313,000)	(19,925,000)	(63,238,000)
DISTRIBUTION--EXPENSES			
DEPT OF LANDS	(10,061,188)	(4,738,812)	(14,800,000)
ENDOWMENT	(2,328,349)	(1,096,651)	(3,425,000)
EARNINGS RESERVE 6/30/03	10,662,593	26,099,336	36,761,929

**PROJECTIONS FOR FY 2002 AND FY 2003 ARE MADE WITH THE FOLLOWING ASSUMPTIONS:**

- 1) THE EQUITY MARKET IS STABLE AT CURRENT LEVELS.
- 2) LAND DEPT RECEIPTS ARE RECEIVED EQUALLY THROUGHOUT THE YEAR.
- 3) EXPENSES ARE ACTUAL APPROPRIATED FOR FY 2002 AND HAVE SLIGHT INCREASES FOR FY 2003
- 4) DISTRIBUTIONS TO BENEFICIARIES ARE AS APPROPRIATED FOR FY 2002 AND HAVE BEEN INSERTED AT 8% FOR FY 2003
- 5) INTEREST INCOME WILL BE HIGHER THAN PROJECTIONS. SHORT TERM INCOME AND DIVIDENDS FROM EQUITIES ARE INCLUDED ON THE CONSERVATIVE SIDE.
- 6) LAND DEPT RECEIPTS PROJECTIONS ARE SPREAD---PUBLIC SCHOOL 60% POOLED 40%.
- 7) DISTRIBUTION FOR FY 2003 HAS BEEN UPDATED WITH THE LEVEL OF 8%.

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**Attachment 1**

**Copy of Approved Land Board Memo September 11, 2001**

*Regular Land Board Meeting – December 11, 2001*

*Agenda Item # 6 – Revised "Variable Spending Policy" and FY 2003 Distribution to Beneficiaries*

State Board of Land Commissioners  
Regular Agenda  
September 11, 2001

Subject

Revised "Variable Spending Policy" and Fiscal Year 2003 Distribution to Beneficiaries.

Background

The endowment funds provide an income distribution to the various beneficiaries of the funds. When investment reform legislation became effective July 1, 2000 the Endowment Fund Investment Board adopted a "Variable Spending Policy" that projected growth of the funds at a level that would provide a larger income flow to the current beneficiaries as well as protect the endowment funds for future generations. Due to unfavorable market conditions, as well as lowered projections for timber revenues, the funds have not grown as anticipated.

Discussion

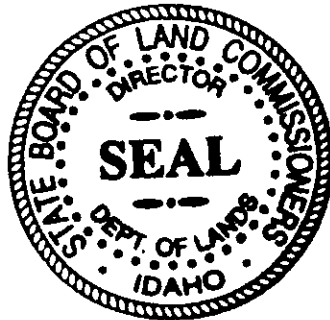
Due to the lowered timber sales projections, there will not be enough revenue to protect the permanent fund and the future distribution to beneficiaries if the percentage is not lowered. The current "Variable Spending Policy" calls for a distribution of 8.5% of the total of each beneficiary fund each year. The Endowment Fund Investment Board has adopted a revised "Variable Spending Policy" which takes into account the current market conditions and the lowered projections for timber revenues. The revised policy recommends a distribution of 7.5% to beneficiaries of each fund's total.

Recommendation

The Endowment Fund Investment Board recommends that the Board of Land Commissioners review and approve the revised "Variable Spending Policy" and lower the distribution percentage from 8.5% to 7.5% beginning in fiscal year 2003.

Board Action

A motion was made by Controller Williams to defer a decision on the Endowment Board's request to lower the current distribution to the beneficiaries from 8½% to 7½%. The board will continue to monitor and discuss this matter. Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 4-0 with Attorney General Lance being absent for this vote.



Attachment

Revised "Variable Spending Policy" and Five Year Distribution to Beneficiaries

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**Attachment 2**  
**Copy of the Revised "Variable Spending Policy"**  
**and Five Year Distribution to Beneficiaries**

*Regular Land Board Meeting – December 11, 2001*

*Agenda Item # 6 – Revised "Variable Spending Policy" and FY 2003 Distribution to Beneficiaries*

**A VARIABLE SPENDING POLICY**  
**for the**  
**STATE OF IDAHO**  
**ENDOWMENT FUND INVESTMENT BOARD**

**Revised August 2001**



The State of Idaho Endowment Fund Investment Board, a standing committee of the Idaho State Board of Land Commissioners, adopted this Spending Policy. This Spending Policy includes the Endowment Fund Corpus, the Earnings Reserve Funds and the Operating Account for the following beneficiary entities: the Public Schools, the Penitentiary, the School of Science, the Agricultural College, the Normal School, the State Hospital South, the Charitable Institutions, and the University of Idaho.

The objectives of this spending policy are as follows:

- A. **To maintain the purchasing power of the Permanent Endowment Funds** - The Endowment Corpus Funds are required to grow at an annual rate equal to a three (3) year moving average of a Composite Index computed as the sum of a general inflation index and an annual population growth rate.
- B. **To maintain fair and equitable inter-generational funding** - The Spending Rule for current beneficiaries is set at a level and growth rate that can be maintained for an extended period of time without jeopardizing the long-term growth required in the permanent endowment funds. The Spending Rule is based on a three (3) year moving average of the market value of the endowment corpus funds.
- C. **To achieve smooth and predictable spending** - An Earnings Reserve Fund is established at a level designed to maintain a relatively constant growth rate of the annual distributions to the beneficiaries.

## Structure

The Idaho Endowment Fund structure is described in terms of a funds flow diagram (Figure below). The diagram is a visual model illustrating how the endowment funds will flow through the system. The diagram is best interpreted from left to right and top to bottom, beginning with the sources of funds on the top left side of the diagram, proceeding with the management of the funds in the center, and distribution of the funds on the right hand side.

## Terms and Definitions

The key endowment terms and definitions are presented below. They are defined in operational and procedural terms in order to allow the reader to understand how they are applied and used in the Spending Policy.

- A. **Endowment Corpus Funds** -- The Endowment Corpus Funds are permanent funds and are to be invested for the purpose of generating future income. These funds are not permitted to be used for current spending. Earnings from the Endowment Funds are to be deposited in the Earnings Reserve Funds. The Endowment Corpus Funds are defined at the end of each accounting year to be the following: Endowment Corpus Funds (at the previous accounting year-end) multiplied by the Composite Index growth rate (consisting of the general inflation index plus the population growth index).
- B. **Earnings** -- Earnings are defined to be all revenues from the management of the Endowment Lands and the Endowment Funds including timber sale proceeds, lease fees, interest, dividends and net realized capital gains. Earnings do not include mineral royalties or land sale proceeds that are deposited directly in the Endowment Funds or net unrealized capital gains that remain in the Endowment Funds until realized.
- C. **Earnings Reserve Funds** -- The Earnings Reserve Funds consist of the accumulated earnings distributed from the Endowment Lands or the Endowment Funds, plus dividends, interest, and realized or unrealized gains on previous earnings reserve balances. All Endowment Land earnings will be deposited directly in the Earnings Reserve Funds and all revenues earned in the Endowment Funds will be transferred into the Earnings Reserve Funds at least every six months. Beneficiary distributions and administrative expenses of the Endowment Fund Investment Board, the Department of Lands and the management fees for all the funds will be appropriated into the designated Operating Account from the Earnings Reserve Funds.
- D. **Operating Accounts** -- The Operating Account consist of the distributions required to be made to the beneficiaries and the operating expenses to be paid for the Department of Lands and the Endowment Fund Investment Board. The

Operating Account also includes any interest or dividends earned on these funds. The beneficiary distributions are subject to legislative appropriation and approval. The interest and dividends earned on the Department of Lands and the Endowment Fund Investment Board's Operating Account will be transferred into their respective Earnings Reserve Funds. The interest and dividends earned on the beneficiary Operating Account belong to the beneficiaries and will be paid out to them.

- E. **Composite Index** -- This is the required annual growth rate for the Endowment Corpus Funds. It is the three- (3) year moving average of the sum of the consumer price index and the Idaho population growth rate for the three previous calendar years.
- F. **Threshold Level** – The Earnings Reserve Funds are to provide sufficient funds to sustain both the beneficiaries' distributions, all related EFIB and DoL expenses and the purchasing power of the Endowment Funds. The Earnings Reserve Funds require a funding level equal to at least 50% of the respective Endowment Corpus Fund.

### **Annual Reviews**

The Spending Rule and the combined funds' asset allocation will be reviewed at least annually by the EFIB to assure that Spending Policy objectives are being met, after a complete analysis by the Manager of Investments and the Investment Management Consultant.

### **Initial Spending Rule**

The initial Spending Rule (annual percentage) will be reviewed and approved annually by the Endowment Fund Investment Board. The amount available for current distribution to the beneficiaries is determined by multiplying the Spending Rule times a three- (3) fiscal year moving average of the market value of the permanent endowment funds. The purpose of the three (3) year moving average is to smooth the annual distributions to the beneficiaries.

- The initial Spending Rule is approved at 7.50% based on the goal of meeting the current spending objectives established for the endowment fund and its beneficiary organizations.
- The Spending Rule will be reviewed at least annually to assure that the Spending Policy objectives are being met optimally.

### **Funding Priorities**

Annual beneficiary distribution is the primary purpose of the Earnings Reserve Fund. Additionally, all EFIB and DoL expenses must be paid. Once these funding requirements have been met, it is required that the Earnings reserve Fund provides for the required growth of the Endowment Corpus fund.

In the event the Endowment Corpus Funds do not grow (in any year) at an annual rate equal to or greater than the required Composite Index growth rate (i.e. the general inflation rate plus the general population growth rate), and the Earnings Reserve Funds have fulfilled the first priority described above, then the additional amount required to bring the Endowment Corpus Funds to their required level will be transferred from the Earnings Reserve Funds to the Endowment Corpus Funds. In the event the level of the Earnings Reserve Funds is insufficient to fund the annual increase required by the Endowment Corpus Funds, the amount of the unfunded contribution will be deferred to the next year and will be added to the next year's required contribution to the Endowment Corpus Funds. All deferred, required contributions to Endowment Corpus Funds are cumulative without limit. The cumulative deferred contributions to Endowment Corpus Funds do not have to be funded from the Earnings Reserve Funds in a single year but may be spread over several subsequent years as determined by the Endowment Fund Investment Board.

In the event the level of the Earnings Reserve Funds is insufficient to fund the annual beneficiary distributions, the amount of the unfunded distributions will be deferred to the next year and will be added to the next year's required distributions. All deferred, required distributions are cumulative without limit. The cumulative deferred distributions do not have to be funded from the Earnings Reserve Funds in a single year but may be spread over several subsequent years as determined by the Endowment Fund Investment Board.

Deferred beneficiary distributions have priority on any available Earnings Reserve Funds over deferred contributions to the Endowment Funds.

### **Future Variable Spending Rule Alternatives**

Once the Earnings Reserve Funds have met or exceeded the Threshold Level, the Endowment Fund Investment Board (EFIB) may consider any one or a combination of three alternatives: modify (increase) the Spending Rule, approve one or more one-time, special distributions or increase the contribution to the Endowment Corpus Fund (and a matching 50% contribution to the Earnings Reserve Funds) above the required Composite Index growth rate. In general, it is anticipated that the Spending Rule will be increased. In the event the Earnings Reserve Funds subsequently fall below the Threshold Level, a new Spending Rule will be established by the Endowment Fund Investment Board based on an updated review of the Spending Policy.

**ENDOWMENT FUND INVESTMENT BOARD**  
**FIVE-YEAR DISTRIBUTIONS TO BENEFICIARIES**  
 Prepared August 2001

	College of Agriculture	Charitable Institutions	Normal School	Penitentiary	School of Science	State Hospital South	University	Total Pooled	Public School
FY 1999 Actual Distributed	771,006	3,074,560	2,585,765	1,070,435	2,911,756	1,276,251	2,393,039	14,082,812	31,844,386
FY 2000 Actual Distributed	850,776	3,284,947	2,799,298	1,108,880	3,252,689	1,377,862	2,555,060	15,229,512	33,336,888
FY 2001 Actual Distributed	1,127,000	4,502,000	3,788,000	1,521,000	4,479,000	1,845,000	3,488,000	20,750,000	44,700,000
FY 2002 Estimate	1,280,000	4,673,000	4,068,000	1,566,000	4,709,000	2,024,000	3,645,000	21,965,000	47,675,000
FY 2003 Projection	1,070,000	3,815,000	3,465,000	1,270,000	3,990,000	1,785,000	3,285,000	18,680,000	40,605,000